

UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

WINIFRED HILL, et al.,)	
)	
Plaintiffs)	
)	
v.)	Civil No. 92-180-P-C
)	
CHRISTOPHER P. MUSSENDEN, et al.,)	
)	
Defendants)	

**RECOMMENDED DECISION ON MOTION FOR
SUMMARY JUDGMENT**

This matter is before the court on the motion for summary judgment of defendants Main Street Management Company ("Main Street"), John Herr and Deborah Holden. The action was initiated by several individuals who assert they were induced by defendant Christopher Mussenden to invest their savings in a fictional trust ("Butterfield & Smith Trust" or "Trust") and in some instances in an unsuitable limited partnership ("Datronics") as well. The plaintiffs assert claims for violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. 78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. 240.10b-5; sections 5, 12(1), 12(2) and 15 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. 77e, 77l(1), 77l(2) and 77o; the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. 1961 *et seq.*; and the Revised Maine Securities Act ("Maine Act"), 32 M.R.S.A. 10101 *et seq.*; and for common-law fraud, conversion, breach of fiduciary duty and negligence.

The Second Amended Complaint contains twelve counts. Counts I, III and IV allege federal securities-law violations and Count VI state securities-law violations; these claims are asserted against all the defendants and are based on sales of the Butterfield & Smith Trust. Counts II and V

are directed against Mussenden only, for sales of Datronics in violation of federal securities laws. Counts VII (state securities-law violations) and VIII (RICO) also involve Mussenden alone. Counts IX through XII are common-law claims against Main Street and Mussenden. Recently the plaintiffs accepted Mussenden's offer of judgment against him on all counts leaving unresolved their claims against Main Street, Herr and Holden.

The remaining defendants ("the defendants") assert that they are not "controlling persons" within the meaning of the Securities Act of 1933 or the Securities Exchange Act of 1934 and therefore cannot be held secondarily liable; that they are not liable under the doctrine of *respondeat superior* because Mussenden was an independent contractor; that Main Street owed no fiduciary duty to the plaintiffs; that many of the claims are barred by various statutes of limitations; and that all claims should be dismissed because of the plaintiffs' own negligence.

I. SUMMARY JUDGMENT STANDARDS

Fed. R. Civ. P. 56(b) provides that "[a] party against whom a claim . . . is asserted . . . may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof." Such motions must be granted if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. P. 56(c). The party moving for summary judgment must demonstrate an absence of evidence to support the nonmoving party's case. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). In determining if this burden is met, the court must view the record in the light most favorable to the nonmoving party and "give that party the benefit of all reasonable inferences to be drawn in its favor." *Ortega-Rosario v. Alvarado-Ortiz*, 917 F.2d 71, 73 (1st Cir. 1990) (citation

omitted). ``Once the movant has presented probative evidence establishing its entitlement to judgment, the party opposing the motion must set forth specific facts demonstrating that there is a material and genuine issue for trial." *Id.* at 73 (citations omitted); Fed. R. Civ. P. 56(e); Local R. 19(b)(2). A fact is ``material" if it may affect the outcome of the case; a dispute is ``genuine" only if trial is necessary to resolve evidentiary disagreement. *Ortega-Rosario*, 917 F.2d at 73.

II. FACTUAL CONTEXT

Mussenden was a National Association of Securities Dealers (``NASD") registered representative associated with Main Street during the periods January 3, 1989 through August 23, 1989 and October 11, 1990 through a date, not agreed upon, in March 1992.¹ *See* Report of Final Pretrial Conference and Order 7. He previously had been associated with broker-dealers Kidder-Peabody, Integrated Resources and Advest. Mussenden Deposition at 18-19, 22-23, 34-35. While he was associated with Main Street, Mussenden operated out of his home in Sarasota, Florida. *See id.* at 3, 32-33; Mussenden Deposition Exh. 3.

It is stipulated that Mussenden developed a bogus security which he called the Butterfield &

¹ In their statement of material facts the defendants indicate that March 4, 1992 was the last date on which Mussenden was associated with Main Street. *See* Main Street Management Company, John Herr, and Deborah Holden's Statement of Material Facts at 28 (Docket No. 36). However, none of the cited references support the March 4 date or any other termination date. One of the defendants' proffered exhibits, an NASD form U-5 (Uniform Termination Notice for Securities Industry Registration), lists March 10, 1992 as the date on which Mussenden was terminated. Defts' Exhs. at 231. The plaintiffs object to the court's consideration of the defendants' exhibits, however, because they have not been submitted in admissible form. *See* Plaintiffs' Memorandum in Opposition to Motion for Summary Judgment (``Plaintiffs' Memorandum") at 11 n.10 (Docket No. 44). Without doubt, the exhibits have been submitted without the required authentication. *See* Fed. R. Civ. P. 56(e); 10A C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* 2722 at 58-60 (1983). Because counsel for the plaintiffs made clear during a telephone hearing on the motion held on May 5, 1993 that the plaintiffs do not concede Mussenden was effectively terminated on March 10, 1992, I will not credit the referenced exhibit. However, in this opinion I do occasionally cite, for completeness sake, to various defendants' exhibits in support of factual statements as to which there is no apparent dispute even though the significance to be attributed to the statement may be in dispute. Were I recommending that summary judgment be granted for the defendants as to any of the disputed issues, which I am not, I would consider myself duty bound to apply Rule 56(e) strictly.

Smith Trust and which was in fact nothing more than two personal bank accounts that he used for his own purposes. Stipulations 1 (Docket No. 54). Mussenden sold shares in the Trust to each of the plaintiffs by making fraudulent misrepresentations concerning the Trust. *Id.* Although the details vary, a common thread runs through the twelve plaintiffs' dealings with Mussenden which form the basis of their claims. *See* plaintiffs' depositions and answers to interrogatories. Prior to investing in the Trust, all of the plaintiffs had purchased legitimate securities through Mussenden and had apparently developed a relationship of trust and confidence in his investment advice. Mussenden contacted each of the plaintiffs concerning the Trust, which he represented to be a safe (or low-risk), high interest (generally 11-12% and, in more than one instance, tax free as well) investment. The plaintiffs responded by writing checks in varying amounts to buy into the Trust. Many of them liquidated other investments in order to invest in Butterfield & Smith. Some of the plaintiffs invested in the Trust more than once. None of them received a prospectus, either before purchase or upon later request. Although they were sent regular statements concerning their other investments with Mussenden, they either did not receive statements on their Butterfield & Smith investments or were sent "suspicious" statements, sometimes bearing what appeared to be a Transamerica logo. The envelopes carried a Florida postmark. With two exceptions, the plaintiffs did not receive interest or dividend checks. They never inquired into the legitimacy of the Trust. They had no communications with Main Street, although the company name, address and phone number appeared on Mussenden's business card. All of the plaintiffs lost the total amount of their investments in Butterfield & Smith.

Main Street is a broker-dealer headquartered in Wallingford, Connecticut. Holden Deposition at 6. Herr and Holden, Herr's daughter, are the officers and shareholders of Main Street. Main Street Ans. to Interrog. No. 1, dated Sept. 17, 1992. In 1988 the company had 10 Offices of Supervisory Jurisdiction ("branch offices") and approximately 125 independent registered agents associated with it. Holden Deposition at 7. It markets itself to independent registered

representatives by offering a less structured working environment than that typically found in traditional firms. *See* Herr Deposition at 10. Herr and Holden are responsible for compliance with securities laws and NASD rules² and oversee all of the company's branch offices. Holden Deposition at 8-9, 58-59. The branch offices are responsible for supervising, on a day-to-day basis, the registered representatives associated with them. *Id.* at 16. The home office is responsible for supervising representatives not associated with a branch office as well as overseeing the branch offices. *Id.* at 16-17. Although there was a branch office in Jacksonville, Florida, Mussenden was supervised by Herr and Holden from the home office. *Id.* at 17-18.

III. LEGAL ANALYSIS

A. Defendants as Controlling Persons

The plaintiffs charge Mussenden with a number of securities violations which are best summarized by reference to Rule 10b-5, promulgated pursuant to the Securities Exchange Act of 1934. It provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the

² The NASD is an organization whose purpose is self-regulation of the over-the-counter ("OTC") securities market. It was formed pursuant to the Maloney Act, Section 15A of the Securities Exchange Act of 1934, which provided for the establishment of national securities associations to supervise the OTC securities market. Its manual includes rules of fair practice. Membership in the NASD entitles a firm to participate in areas of investment banking and OTC securities business on a preferential basis, to distribute new issues that have been underwritten by NASD members and to distribute shares of investment companies which are sponsored by NASD members. Members are obliged to conform to standards of ethical conduct. National Association of Securities Dealers, Inc., *reprinted in* National Association of Securities Dealers Manual, CCH, 1991 101-02.

statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. 240.10b-5.

The defendants argue that neither Main Street, as a broker-dealer, nor Herr or Holden, as individuals, can be held secondarily liable for Mussenden's violative acts because they are not controlling persons within the meaning of 15 U.S.C. 77o and 78t. Memorandum of Law in Support of Motion for Summary Judgment ("Defendants' Memorandum") at 2-10 (Docket No. 35).

The plaintiffs emphasize that Mussenden was able to sell securities because Main Street licensed him and that it was obligated, but effectively failed, to supervise him. Plaintiffs' Memorandum at 2-3.

Section 77o provides for the liability of controlling persons, stating:

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l³ of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. 77o. Section 78t(a) provides:

Every person who, directly or indirectly, controls any person liable

³ Section 77l applies in this case because it provides for the liability of persons who violate 15 U.S.C. 77e, which requires that securities be registered and prospectuses be sent before the mails or any means of interstate commerce are used in the sales of those securities.

under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. 78t(a).

The defendants also assert that they are not controlling persons under state securities laws. Defendants' Memorandum at 24-25. Section 10201 of the Maine Revised Securities Act prohibits fraudulent and deceptive acts and practices, untrue statements and material omissions in connection with the offer, sale or purchase of any security. Section 10605(3) of the Act provides for controlling-person liability as follows:

Every person who directly or indirectly controls another person liable [for violations of various sections including 10201], every partner, officer or director of that other person, every person occupying a similar status or performing similar functions . . . and every broker-dealer or sales representative who materially aids in the act or transaction constituting the violation is also liable jointly and severally with and to the same extent as that other person, unless the person otherwise secondarily liable under this Act proves that the person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

32 M.R.S.A. 10605(3).

Neither of the federal securities statutes nor the Maine statute defines a "controlling person." However, 17 C.F.R. 230.405 states that the terms "control" and "controlling" mean "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

The defendants stress the independent nature of Mussenden's relationship with Main Street and, therefore, their own lack of control over his behavior and transactions. Mussenden was

viewed by Main Street as an independent contractor. Main Street Ans. to Interrog. No. 12. He certainly was attracted to the company because of its "lighter atmosphere." Mussenden Deposition at 58-60. Main Street's sales pitch is aimed at independent practitioners. Herr Deposition at 10. In recruiting representatives, the company, through Herr, emphasizes the lack of sales quotas or proprietary products. *Id.* at 13-14. Representatives are allowed to maintain an outside insurance business as well. *Id.* at 15. When legitimate sales were made by Mussenden, Main Street received 10% of the commission, while Mussenden retained 90%. Mussenden Deposition at 94-95. The fraudulent sales of Butterfield & Smith Trust were made without the knowledge of Main Street or its officers. *See* Herr Deposition at 48-52.

A review of circuit court decisions reveals a lack of uniformity in analysis of controlling-person liability. I find persuasive the view of the Eighth Circuit as expressed in *Martin v. Shearson Lehman Hutton Inc.*, 986 F.2d 242 (8th Cir. 1993). That court has held that section 78t(a) "reaches persons who have only 'some indirect means of discipline or influence' less than actual direction." *Id.* at 244 (quoting *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1987), *cert. denied*, 390 U.S. 951 (1968)). Noting that "liability [does] not depend on the controlling person's having exercised control over the particular transaction that [gives] rise to the violation," the court found in that case that even though the broker's solicitations were contrary to the firm's instructions and the sales were not consummated through the firm, the fact that the broker was Shearson's employee was enough to establish controlling-person liability. *Id.* Thus, the relationship between Main Street as broker-dealer and Mussenden as its registered representative, even as an independent contractor, might be enough to confer controlling-person status on the company.

The Ninth Circuit has adopted this view as well, holding that a broker-dealer is a controlling person with respect to its registered representatives. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1574 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991). To establish that the broker-dealer is a controlling person, a plaintiff need only show that the representative was employed by *or*

associated with that broker-dealer.⁴ *Id.* The court observed that under federal law “a person cannot lawfully engage in the securities business unless he is either registered or associated with a broker-dealer.” *Id.* It went on to state:

[W]e see no basis in the statutory scheme to distinguish between those associated persons who are employees and agents on the one hand, and those who are independent contractors on the other. To exclude from the definition of controlling person those registered representatives who might technically be called independent contractors would be an unduly restrictive reading of the statute and would tend to frustrate Congress' goal of protecting investors. Thus, we reject the argument that broker-dealers can avoid a duty to supervise simply by entering into a contract that purports to make the representative, who is not himself registered under the [Securities Exchange Act of 1934] as a broker-dealer, an “independent contractor.”

Id.

Under the definition of “control” found at 20 C.F.R. 203.405, it is arguable that Herr and Hill are controlling persons because, as officers of the company responsible for compliance with securities statutes and NASD rules, they have the authority to determine the direction of management and the policies of the company. This includes the power to determine how contracts and contacts with independent registered representatives will be handled. It also includes the power and responsibility to establish the “corporate culture” concerning sales. In sum, I conclude on this summary judgment record that there remains a genuine dispute as to whether the defendants are controlling persons.

Assuming, *arguendo*, that all of the defendants are controlling persons, the question remains whether a “good faith” defense is available to them. The defendants argue that, despite their reasonable supervision of Mussenden, they were unaware of his fraudulent activities and therefore

⁴ The court specifically rejected the “culpable participation” standard it had used in deciding earlier cases. 914 F.2d at 1574-75. I note, however, that some courts continue to employ a more restrictive standard. *See, e.g., Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873 (7th Cir. 1992) (court must ask first whether alleged controlling person exercised actual control over controlled person and, if so, whether it had power to control particular transaction that caused harm).

should not be held liable. *See* Defendants' Memorandum at 10-16. The plaintiffs assert that even if the defendants were not aware, their lax attitude toward compliance, their violation of the NASD Rules of Fair Practice and their failure to investigate Mussenden's background make them responsible. *See* Plaintiffs' Memorandum at 22-26.

Although the circuits are split as to what actions on the part of a brokerage firm are sufficient to constitute a "good faith" defense, it is at least clear that the defendant has the burden of proving good faith. *Kravitz v. Pressman, Frohlich & Frost, Inc.*, 447 F. Supp. 203, 212 (D. Mass. 1978). "[I]t must be shown that the controlling person maintained and enforced a reasonable and proper system of supervision and internal control over controlled persons so as to prevent, as far as possible, violations of 10(b) and Rule 10(b)-5." *Id.* at 213 (citation omitted). "The controlling inquiry is whether or not sufficient precautionary measures were taken to prevent the type of loss which in fact occurred." *Id.*

The defendants' version of the facts concerning Mussenden's association with Main Street, their supervision of him and their internal controls may be summarized as follows. Mussenden's first contact, in December 1988, was with Herr by telephone followed by telephone conversations with Holden regarding paperwork, getting set up and how the company functioned. Holden Deposition at 20. Holden went through the compliance manual requirements with him and sent him a copy for his acknowledgement that he had read and understood the information. *Id.* at 20-21; Defts' Exhs. at 174. Specific compliance matters discussed included processing of orders and licensing. Holden Deposition at 21. Holden also sent Mussenden a fingerprint card, a U4 form (Uniform Application for Securities Industry Registration or Transfer) and related documentation, also to be completed and returned. Holden Deposition at 21; Defts' Exhs. at 169-177. Each time Mussenden applied for association with Main Street, she called one of his previous employers, Integrated Resources (in January 1989) and Meridian (when he returned to Main Street in October 1990), but no others. Holden Deposition at 23-25, 37. In April 1989 she sent him additional

materials, including recent amendments to Main Street's compliance manual, acknowledgement forms and a supervisory questionnaire, which he completed.⁵ *Id.* at 39; Defts' Exhs. at 180-189.

Main Street requests each of its associated representatives to complete a new account form for new customers or those old customers the representative brings with him to the company. Holden Deposition at 42. This form contains financial and "suitability" information concerning the customer. *Id.* at 43. Herr or Holden approves these forms. *Id.* at 46. Main Street maintains a filing system by representative in which customers' files are placed; the files contain applications, checks, year-end statements and correspondence. *Id.* at 51-52. Main Street does not contact representatives' customers directly. *Id.* at 52. Herr held two compliance meetings with Mussenden (in 1989 and 1991) during which he went through "the regular procedures from A to Z," meaning the compliance manual and the forms the representatives must complete each year. Herr Deposition at 24-25, 39. Both meetings were held at a restaurant. *Id.* at 24, 37.

Mussenden takes a very different view of the supervision provided. According to him, Main Street "didn't control anything." Mussenden Deposition at 59. Mussenden and Main Street had "basically . . . very little contact." *Id.* at 60. Notwithstanding that Herr also maintained a residence in Sarasota, he and Mussenden met only twice, briefly, once at a restaurant and once at a coffee shop. *Id.* at 37. The meeting place was chosen for mutual convenience, as both Herr and Mussenden had residences in the Siesta Key area. Herr Deposition at 19. The so-called compliance meetings were "a bunch of questions." *Id.* at 38. Herr asked about Mussenden's records and whether he understood rules and regulations. *Id.* Mussenden did not complete the supervisory compliance questionnaire at their first meeting, but mailed it to Main Street at some other time. *Id.* at 38-39. Mussenden understood that he had to attend a minimum of one compliance meeting a year. *Id.* at 41. Main Street offered him one or more compliance meetings but when Mussenden told them that "none [were] convenient enough to spend that kind of money

⁵ The questionnaire is reviewed during a compliance meeting. Holden Deposition at 40.

for a plane trip," Holden told him he did not have to attend. *Id.* at 42. The meeting he had with Herr in 1991 was to take the place of a compliance meeting but lasted no more than one-half hour. *Id.* at 80. There was no discussion of order-processing procedures or new account forms. *Id.* at 49-50. Herr did not discuss the requirement of reporting all outside business. *Id.* at 50. Although Mussenden had read the compliance manual, no one from Main Street ever discussed it with him. *Id.* at 57.

It is clear that genuine issues of material fact remain in dispute concerning the defendants' entitlement to the benefit of a "good faith" defense, including whether they should have been able to manage or direct Mussenden's activities and, if so, whether the procedures they employed for supervision were adequate to have prevented the loss of the plaintiffs' funds.

B. Vicarious Liability

The defendants assert that they are not liable for Mussenden's negligent or intentional acts under the doctrine of *respondeat superior* because Mussenden was an independent contractor, but that even if a master-servant relationship existed, his acts were performed outside the scope of his contractual relationship with Main Street and therefore no liability attaches. *See* Defendants' Memorandum at 25-33. Their argument that no master-servant relationship existed is based on a document signed by Mussenden that suggests he was an independent contractor and that he received none of the benefits or services normally provided to an employee of Main Street, Defts' Exhs. at 226, and a letter from Herr to Mussenden welcoming him to Main Street as an "independent financial planning practitioner," Defts' Exhs. at 178. The plaintiffs emphasize Main Street's right and obligation to supervise Mussenden's trading activities rather than his contractual status. Plaintiffs' Memorandum at 30.

At least one court has stated that the fact that the parties choose the label "independent contractor" is not the controlling factor. Instead, "the right of one party to control not only the

result to be achieved by the other, but also the means and manner of performing the task assigned, is the most critical factor in ascertaining whether an employment relationship exists." *Holt v. Winpisinger*, 811 F.2d 1532, 1539 (D.C. Cir. 1987). This is consistent with the approach taken by the Restatement (Second) of Agency 220 (1958), which sets out ten factors to be considered in deciding whether a person is a servant or an independent contractor. Comment d to section 220 states that "[a]lthough control or right to control the physical conduct of the person giving service is important and in many situations is determinative, the control or right to control needed to establish the relation of master and servant may be very attenuated." *Id.* It is a question of fact for trial whether the manner in which Main Street dealt with Mussenden establishes him as its servant.

The defendants contend that even if there was a master-servant relationship between Mussenden and Main Street, the master cannot be held liable for acts of a servant occurring outside the scope of his employment and authority. Defendants' Memorandum at 27. The defendants first learned of Mussenden's fraudulent activities when Holden received a call from Transamerica Funds indicating that there was a "serious problem" and that they would be contacting the NASD. Holden Deposition at 70-71. In response, Main Street did not contact Mussenden's customers, but took his name off applications and statements so he could no longer trade. *Id.* at 75-76. Some of the plaintiffs did not find out about Mussenden's fraudulent activities until they read about the investigation in the newspaper or were contacted by state government officials. *See, e.g.,* Hauptvogel's Ans. to Interrog. No. 14; Noyes' Ans. to Interrog. No. 14.

While the mere fact that the broker's business relates to securities generally is not sufficient to convert illegal acts into acts within the scope of employment, *see, e.g., Moss v. Morgan Stanley, Inc.*, 553 F. Supp. 1347, 1356 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied sub nom. Moss v. Newman*, 465 U.S. 1025 (1984), in the context of securities law conduct may fall within the scope of employment even if it is unauthorized if it is sufficiently similar to authorized conduct, *Lewis v. Walston & Co.*, 487 F.2d 617, 624 (5th Cir. 1973) (although transactions were unregistered

and trades took place outside of the business and no commissions were received, brokerage firm was liable because it had supplied sales person with instrumentality by which the harm was caused, *i.e.*, access to securities market). I conclude that there is also a genuine dispute as to whether Mussenden, even if Main Street's servant, acted within the scope of his employment and authority.

The defendants assert that they are not liable under any other agency theory. *See* Defendants' Memorandum at 33-36. However, the First Circuit has ruled that corporations may be held vicariously liable for the securities-related misrepresentations of their officials, at least in respect to the common-law theory of apparent authority. *In re Atlantic Financial Management, Inc.*, 784 F.2d 29, 30-31 (1st Cir. 1986), *cert. denied sub nom. AZL Resources, Inc. v. Margaret Hall Found.*, 481 U.S. 1072 (1987). Under the theory of apparent authority, [t]he agent's tortious action, while not actually authorized by the corporation, appears so to those adversely affected. Vicarious liability is based upon the fact that the agent's position facilitates the consummation of the fraud, in that from the point of view of the third person the transaction seems regular on its face and the agent appears to be acting in the ordinary course of the business [confided] to him."

Id. at 32 (citation omitted; quoting Restatement (Second) of Agency 261 cmt. a (1958)). The court's rationale in adopting the theory of vicarious liability in the securities context was that, "as between the corporation that has placed the official in a position to invoke its authority (though improperly) and a victim, it seems fairer that the former bear the burden of an uncompensated loss."

Id. In addition, the court indicated it expects the exposure to such liability to encourage corporate officials to prevent unauthorized misrepresentations and thus help to achieve an important purpose of the Securities Act of 1934. *Id.*

The court also noted the difference between section 78t(a), which requires a finding of liability unless the controlling person acted in good faith and did not induce the violation, and common-law agency theories which impose liability even without these preconditions. *Id.* at 30. If

further made clear that section 78t(a) is not the exclusive remedy for securities violations and therefore does not preclude the imposition of vicarious liability where it would otherwise exist. *Id.* at 32. In addition, Congress' purpose in enacting 78t(a) was to expand liability rather than contract it. *Id.* at 33. I conclude, therefore, that whether or not the defendants are controlling persons for the purposes of section 78t(a), and whether or not they offer a "good faith" defense, there remains a genuine issue as to whether they may be found vicariously liable under the common-law theory of apparent authority.

C. Statutes of Limitations

The defendants argue that many of the plaintiffs' federal and state securities-act claims are barred by applicable statutes of limitations. Defendants' Memorandum at 19-24, 25. The claims asserted against the defendants pursuant to section 12 of the 1933 Act are subject to the one- and three-year limitations periods contained in section 13, 15 U.S.C. 77m. Under this provision, suit must be commenced within one year after discovery of the violation and, in any event, within three years of the violation. The same limitations structure applies with respect to the claims asserted against the defendants pursuant to sections 10(b) and 20(a) of the 1934 Act, 15 U.S.C. 78j(b) and 78t(a), and Rule 10b-5. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2781 (1991). The three-year limitations period is an outside limit and is not subject to the doctrine of equitable tolling. *Id.* at 2782. Claims asserted under section 10201 of the Maine Act must be brought "within 2 years after the discovery of the violation or after discovery should have been made by the exercise of reasonable diligence." 32 M.R.S.A. 10201.

Plaintiff Abrahamsen concedes that his federal-act claims against the defendants are altogether time-barred.⁶ Plaintiff Merrill concedes that his federal statutory claims against the

⁶ Abrahamsen invested in the Butterfield & Smith Trust on April 26, 1989, more than three years prior to May 11, 1992, the date on which this action was commenced by the filing of the original complaint.

defendants based on his April 25, 1989 investment in Butterfield & Smith Trust are time-barred.⁷ And plaintiff Stackpole acknowledges that her comparable claims relating to an April 19, 1989 investment in the Trust are also time-barred.⁸ *See* Plaintiffs' Memorandum at 27-28. Thus, the defendants are entitled to summary judgment in their favor against these plaintiffs on these count I, III and IV claims.

At issue is whether the one-year federal-act limitations period bars the federal securities-act claims of plaintiff Hill relating to investments made in the Butterfield & Smith Trust on December 2, 1990 and on January 26 and March 28, 1991⁹ and of Merrill made in January 1992, and whether the two-year state-act limitations period bars the state securities-act claims of Abrahamsen, Merrill (April 25, 1989 investment only) and Stackpole (April 19, 1989 investment only).¹⁰ *Id.* at 28; *see also* Exh. B to Defendants' Memorandum. The defendants do not suggest that these plaintiffs discovered Mussenden's fraud more than one year or, in the case of the state-act claims, more than two years prior to commencement of this action; they argue only that they should have.

Under federal law, the federal-act one-year statute-of-limitations period will begin to run even in the absence of an actual discovery of a fraud if and when a plaintiff, exercising reasonable diligence, should have discovered the fraud. *Cook v. Avien, Inc.*, 573 F.2d 685, 694-95 (1st Cir. 1978). The Maine two-year statute effectively codifies the federal rule.

⁷ Merrill made a second investment in the Trust in January 1992.

⁸ The Stackpoles made a third investment on January 19, 1992. They also made an investment in the Trust on October 18, 1988 but no claim is asserted against the remaining defendants with respect to this investment since Mussenden was not then associated with Main Street.

⁹ Hill made two earlier investments in the Trust, one on July 30, 1990 and the other on August 2, 1990, both at a time when Mussenden was not associated with Main Street. This is also the case as to plaintiff Dyer's investment in the Trust in June 1988. Accordingly, no claims are asserted against the defendants respecting these investments.

¹⁰ The pendant state common-law claims are governed by Maine's general six-year statute of limitations. The defendants do not assert that any of these claims are time-barred.

The burden of showing compliance with a statute of limitations is on the plaintiff. *Id.* at 695. In determining whether an investor has been duly diligent a court must consider all relevant factors, including the nature of the fraudulent activity, the opportunity to discover it and the subsequent actions of the parties. *See id.* at 696-97. The exercise of due diligence requires an investor to be "reasonably cognizant" of financial developments relating to his investment. *Id.* at 698. The question of whether reasonable diligence has been exercised is necessarily fact-based. *Id.* at 697.

Abrahamsen had invested with Mussenden to his satisfaction for between four and five years, involving a total of 10 to 15 transactions, prior to his investment in the Trust on April 26, 1989. Abrahamsen Deposition at 4; Abrahamsen Ans. to Interrog. No. 5. The statements he had received on previous investments made through Mussenden had always reflected the amounts invested. Abrahamsen Ans. to Interrog. No. 12. He invested in Butterfield & Smith even though Mussenden's description of the investment left him feeling a little leery. Abrahamsen Deposition at 5. Approximately two to four weeks after he requested and was promised a Butterfield & Smith prospectus, but received none, he "knew something was wrong." Abrahamsen Deposition at 6, 11. He then contacted Cozad, the last place where he knew Mussenden was working,¹¹ and all the brokerage houses listed on prior statements. *Id.* at 6-7. He did not hear from Mussenden or, despite his persistent efforts to find him, discover his whereabouts between the time he became suspicious in May or June of 1989 and August or September of 1992 when he finally tracked him down. *Id.* at 7, 9, 11-12. At that point Mussenden confessed that he had misappropriated the funds for his personal use. *Id.* at 7-8.

Merrill likewise had a satisfactory history of investments with Mussenden dating from 1985. Merrill Ans. to Interrog. No. 5; Merrill Deposition at 6-7. In April 1989 Mussenden

¹¹ Mussenden was affiliated with Cozad during the hiatus between his two associations with Main Street. Mussenden Deposition at 32-33, 35.

approached Merrill with the proposal to invest in Butterfield & Smith explaining that it was like a certificate of deposit inasmuch as an investor receives interest and a return of principal, that it was altogether tax free and that it paid a return of 10 or 11%. Merrill Deposition at 7-8. Merrill made his first investment in the Trust without reservation. *Id.* at 8. He made his second investment in January 1992 by mailing Mussenden an \$8,000 check he had received. *Id.* at 12-13. Merrill thought it strange that Mussenden discouraged him from placing a restrictive endorsement on the check before mailing. *Id.* at 13. Between April 1989 and January 1992 Merrill received probably two Butterfield & Smith statements listing Royal Alliance as the broker. *Id.* at 15. Merrill contacted Mussenden by phone in February and September of 1991 when he did not receive any dividends. Merrill Ans. to Interrog. No. 9(2). Mussenden told him the dividends were sent to Mussenden in error and then sent Merrill "some money" assuring him that it would not happen again. *Id.* Merrill learned of Mussenden's fraud within a few weeks after he made his second investment when he was contacted by the Maine Securities Division. Merrill Deposition at 10, 13-14.

The details concerning Hill's investments are somewhat sketchy. However, Hill had placed investments with Mussenden for 20 years, primarily in the Oppenheimer High Yield Fund. Hill Ans. to Interrog. No. 5. She made several investments in Butterfield & Smith at the urging of Mussenden, including investments on December 7, 1990, January 26, 1991 and March 28, 1991. *See* Report of Final Pretrial Conference and Order 7; Appendix A to Plaintiffs' Pretrial Memorandum (Docket No. 42). Mussenden had told her that the Trust was a high-yield tax-free investment. Hill Ans. to Interrog. No. 13. She became "suspicious" when Mussenden began ignoring her calls and "money wasn't coming in." *Id.* She apparently discovered the fraud when she was contacted in April 1992 by the Maine Attorney General's Office in regard to an ongoing investigation of Mussenden. Hill Ans. to Interrog. No. 9.

The Stackpoles had invested with Mussenden on three occasions, beginning in 1982, before

purchasing their first interest in Butterfield & Smith on October 18, 1988. Stackpole Ans. to Interrog. No. 5; Stackpole Deposition at 3-7. They made a total of three purchases of Butterfield & Smith. Stackpole Deposition at 6-7. Although they were supposed to receive checks twice a year, they received only one \$250 check about six months after their first investment. *Id.* at 7. When they complained to Mussenden that they had not received another check, he explained that there had been a mix-up with another fund (Seligman) and said that they could just reinvest future dividends from Butterfield & Smith. *Id.*; Stackpole Ans. to Interrog. No. 9. As they did not need the money then but were more concerned about the future, they agreed. Stackpole Deposition at 7-8. They were not suspicious when they did not receive statements because Mussenden had told them in the beginning that they would not. *Id.* They did receive a statement in the spring of 1991 when Mr. Stackpole requested one. *Id.* at 8-9. They received a total of three statements on Butterfield & Smith. *Id.* at 10. They found out about Mussenden's fraudulent activities when they were contacted by the Maine Securities Division in April 1992. *Id.* at 9.

While the summary judgment record suggests that plaintiffs did little if anything when they failed to receive income or statements concerning their Butterfield & Smith Trust investments, it also supports their claim that their trust and confidence in Mussenden and their reliance on his assurances to them were reasonable in the context of their history of prior successful dealing with him. I conclude, therefore, that there remains a genuine issue for trial on the due-diligence aspect of the statute of limitations issue.

D. Fiduciary Duty

In count XI the plaintiffs assert vicarious-liability and direct claims against Main Street for breach of fiduciary duty. Specifically, they allege that Mussenden breached a duty "to invest their funds suitably, to disclose accurate information regarding the recommended investments and to advise [them] properly concerning those investments," and that Main Street is liable therefor during

the periods of Mussenden's affiliation with it under principles of *respondeat superior*. Second Amended Complaint 147-149. They also allege that "by virtue of its position as broker-dealer," Main Street owed them a fiduciary duty to "insure that [their] funds were suitably invested and that [they] were given accurate information and proper advice by Main Street Management's registered representative Mussenden," and that it breached this duty as well. *Id.* 150-151. Main Street argues that it owed no fiduciary duty to the plaintiffs. Defendants' Memorandum at 37.

It is clear that a broker owes a fiduciary duty of care and loyalty to a securities investor. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987). The fiduciary concept is derived from trust and agency principles. *Id.* However, the nature of the fiduciary duty owed will vary depending on the relationship between the broker and the investor. *Romano v. Merrill, Lynch, Pierce, Fenner & Smith*, 834 F.2d 523, 530 (5th Cir. 1987), *cert. denied*, 487 U.S. 1205 (1988). This determination is necessarily fact-based. *Id.* The evaluation "requires consideration of the degree of trust placed in the broker and the intelligence and personality of the customer." *Id.* (citation and internal quotation marks omitted). Courts have found different duties owing to a securities customer based on whether an account is discretionary or nondiscretionary.¹² *Id.*; *Gochnauer*, 810 F.2d at 1049 n.9. It is apparent from the summary judgement record that the plaintiffs had a fiduciary relationship with Mussenden. Whether Main Street can be held vicariously liable for his breaches of duty depends, however, on the nature of its relationship with him. I have previously explored that subject, *supra* at 14-18, and concluded that there remains a genuine dispute as to whether Mussenden was Main Street's servant and, if so, whether in dealing with the plaintiffs as he did he acted within the scope of his employment and authority.

While it is clear that the plaintiffs had a fiduciary relationship with Mussenden, it is not so

¹² A discretionary account is one concerning which the broker has a continuous management obligation. A nondiscretionary account is one where the customer and broker consult as to a specific transaction but the broker has no continuing management duty once the single transaction is completed. *Gochnauer*, 810 F.2d at 1049 n.9.

clear that they had one directly with Main Street. Although Main Street's name was on Mussenden's business cards and may have appeared on the phony statements sent to clients, there is no indication that the plaintiffs relied on Main Street for advice, even if they were aware of its existence. However, some courts have extended fiduciary-duty liability to the broker-dealer as well as to the representative or investment advisor who had the immediate relationship with the client. *See, e.g., Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 803 F.2d 454, 461 (9th Cir. 1986). It is not necessary for the broker-dealer to accept a fiduciary responsibility in contractual terms of offer and acceptance. *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 822 (9th Cir. 1980). Whether a sufficient relationship existed or may be imputed between Main Street and the plaintiffs is an issue for trial.

E. Plaintiffs' Negligence

Finally, the defendants argue that all of the plaintiffs' claims should be barred by their own negligence, asserting that if they had exercised the minimum due diligence required of any investor in making these investments they would have discovered the fraud. Defendants' Memorandum at 38-40. In addition to *scienter*, the traditional elements of a section 10b-5 action are material omissions and/or misrepresentations, reliance and due care by the plaintiff. *Xaphes v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 600 F. Supp. 692, 694 (D. Me. 1985). This court will find due diligence on the part of the plaintiff if he has not acted recklessly. *Id.* Recklessness is defined in terms of whether the plaintiff refused to investigate "in disregard of a risk so obvious that [he] must be taken to have been aware of it, and so great as to make it highly probable that harm would follow." *Id.* (quoting W. Prosser, *Handbook of the Law of Torts* 34 at 185 (4th ed. 1971)) (other citations omitted). The Fifth Circuit in *Dupuy v. Dupuy*, 551 F.2d 1005 (5th Cir.), *cert. denied*, 434 U.S. 911 (1977), cited favorably by this court in *Xaphes*, has stated that the role model for a plaintiff is an investor with the attributes of the plaintiff rather than the average investor. *Id.* at

1016.

I note that several of the plaintiffs are college graduates and at least one has an advanced degree. *See generally* plaintiffs' answers to interrogatories. However, they all had histories of satisfactory investment experience with Mussenden prior to their investments in Butterfield & Smith. *See generally* plaintiffs' depositions and answers to interrogatories. Whether the plaintiffs acted recklessly is, on this record, a subject of genuine dispute resolvable only at trial.

IV. CONCLUSION

For the foregoing reasons, I recommend that the defendants' motion for summary judgment be **GRANTED** as to the count I, III and IV federal-act claims of plaintiffs Abrahamsen, Merrill (but only as to his April 25, 1989 Butterfield & Smith investment) and Stackpole (but only as to the Stackpoles' April 19, 1989 Trust investment) and in all other respects ***DENIED***.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated at Portland, Maine this 6th day of May, 1993.

David M. Cohen
United States Magistrate Judge